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Supreme Court of the United States
OCTOBER TERM, 1987

SHELL OFFSHORE INC., *et al.*,
Petitioners,

v.

ASSOCIATED GAS DISTRIBUTORS, *et al.*,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTIONS PRESENTED

1. Did the court of appeals err in disregarding Natural Gas Policy Act ("NGPA") limits on the Federal Energy Regulatory Commission's ("Commission") authority to interfere with producer contracts?

2. Did the court of appeals err in failing to defer to the Commission's decisions on factual and policy matters which are within the Commission's discretion?

3. Did the court of appeals err in remanding an order of the Commission for failing to consider adequately an issue in this proceeding which the Commission was addressing in other proceedings?

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

The undersigned producers of natural gas (Producers)[1] petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in *Associated Gas Distributors v. FERC*, 824 F.2d 981 (D.C. Cir. 1987) (hereinafter "*AGD*").

OPINION BELOW

The opinion of the court of appeals (App. 1a-128a) is reported as *Associated Gas Distributors v. FERC*, —— U.S. App. D.C. ——, 824 F.2d 981 (1987). The Notice of Proposed Rulemaking of the Federal Energy Regulatory Commission ("Commission") is reported at 50 Fed. Reg. 24,130. The order accompanying issuance of the

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[1] Petitioners are listed on the inside cover.

Final Rule by the Commission (Order No. 436) is reported at 50 Fed. Reg. 42,408 (October 18, 1985), 50 Fed. Reg. 45,907 (November 5, 1985) (corrected) and FERC Stats. & Regs. (Regs. Preambles 1982-85) (CCH) ¶ 30,665. App. 129a-144a (excerpts). The Commission's order denying rehearing (Order No. 436-A) is reported at 50 Fed. Reg. 52,217 (December 23, 1985) and FERC Stats. & Regs. (Regs. Preambles 1982-85) (CCH) ¶ 30,675. App. 145a-163a (excerpts). Order Nos. 436 and 436-A were further modified in Order No. 436-B, 51 Fed. Reg. 6398 (Feb. 24, 1986), III FERC Stats. & Regs. (Regs. Preambles) (CCH) ¶ 30,688 (1986); *reh'g denied*, Order No. 436-C, 51 Fed. Reg. 11,566 (April 4, 1986), 34 FERC (CCH) ¶ 61,404 (1986); *reh'g denied*, Order No. 436-D, 51 Fed. Reg. 11,569 (April 4, 1986), 34 FERC (CCH) ¶ 61,405 (1986); *reconsideration denied*, Order No. 436-E, 51 Fed. Reg. 11,566 (April 4, 1986), 34 FERC (CCH) ¶ 61,403 (1986).

JURISDICTION

The judgment of the court of appeals (App. 164a-167a) was issued on June 23, 1987. Applications for rehearing *en banc* were denied on September 15, 1987 (App. 171a). The jurisdiction of this Court is invoked under Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b), Section 506(a)(4) of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3416(a)(4), and 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

Sections 4, 5, 7, 16 and 19 of the Natural Gas Act of 1938 ("NGA"), 15 U.S.C. §§ 717c, 717d, 717f, 717o, and 717r, and Sections 311 and 601 of the Natural Gas Policy Act of 1978 ("NGPA"), 15 U.S.C. §§ 3371 and 3431, are set out in the Appendix to this Petition (App. 173a-196a). The Regulations adopted in the Order No. 436 series are codified primarily in 18 C.F.R. Part 284 (1987).

STATEMENT OF THE CASE

The Commission's Orders below may rank as a "great regulatory milestone of the industry[.]"[2] The Commission seeks to increase competition and facilitate consumer access to market-priced supplies of natural gas. The Commission found that a refusal by an interstate pipeline to transport gas for third parties, where to do so would displace its own sales, is "unduly discriminatory" under Section 5 of the NGA. The Orders below require pipelines that elect to transport gas for others in self-implementing transactions to "unbundle" their roles as both transporters and merchants, and begin operating on an "open-access" basis. The Commission found,[3] and the court of appeals agreed,[4] that the development of a nationwide pipeline network had made it possible for consumers to secure supplies from any region of the country, and that regulatory policies which allowed consumers access to those supplies fulfilled the fundamental purpose of the NGA, which is to protect interstate gas consumers from pipelines' monopoly power. The court of appeals rejected challenges to the Commission's Orders on a wide variety of issues, affirming the Commission's actions as within its discretion to carry out its statutory mandate under the NGA and NGPA.

Nevertheless, the court of appeals remanded these Orders to the Commission on four grounds:

> (1) The Commission was directed to "reassess" its refusal to impose conditions under Section 5 of the NGA deleting or modifying take-or-pay provisions of producer/pipeline contracts still subject to the Commission's NGA jurisdiction.[5]

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[2] App. 17a.

[3] App. 130a.

[4] App. 20a.

[5] App. 90a-91a.

(2) The Commission was directed to reexamine its finding that policy considerations, as well as doubts as to the scope of its legal authority, militated against the imposition of a condition that a producer must offer "credits" against the take-or-pay provisions of its contracts in order to participate in the "open-access" transportation afforded by Order No. 436, and to reach its conclusion by "reasoned decisionmaking." [6]

(3) The Commission had not adequately justified the contract demand reduction provision, which enabled distribution companies and end-users to reduce the quantities of gas which they had agreed to purchase from their pipeline suppliers, in order to allow them to purchase gas directly from producers and transport it under the open-access program.[7]

(4) The Commission had failed to adequately explain the grandfathering of certain transportation programs.

This Petition addresses only the first two grounds for the remand.

Historically, natural gas has been sold under long-term contracts. For decades, natural gas sales contracts have given pipelines or other purchasers exclusive rights to the gas from specific wells or acreage. In return for these commitments, the purchasers assured producers of minimum cash flows by agreeing to take a specific percentage of the dedicated gas or to pay for gas not taken. The contracts further provided that if the pipelines were unable to take the contract quantities of gas, so that the payment provisions were invoked, the pipelines would "make up" the quantities paid for but not taken, at some

[6] App. 94a.

[7] In its "Interim Rule" on remand, Order No. 500, issued August 7, 1987, 52 Fed. Reg. 30,334 (August 14, 1987), the Commission agreed to delete this provision from its program.

later time[8] more convenient to the pipelines. In the gas industry, these contract provisions are called "take-or-pay" provisions.

The NGPA was enacted to remedy shortages which had developed in the interstate gas market during the 1970's. Responding to the "incentive prices" offered in the higher-priced categories of gas by the NGPA, producers drilled high-cost wells beginning in 1979. Pipeline companies entered into contracts with producers agreeing to pay the maximum lawful prices permitted by Congress,[9] and to further encourage drilling, agreed to provisions requiring the pipeline purchaser to take, or, if not taken, to pay for, high percentages of the quantities of gas which the wells were capable of producing.

The pipelines' ability to pay prices higher than the average field market price for some categories of gas was enhanced by the "vintage pricing system" under the NGPA under which widely ranging maximum lawful prices were established.[10] Pipelines "roll in" all of these varying prices in their resale rates, charging their customers rates based on the weighted average cost of gas ("WACOG") incurred by the pipelines.[11]

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[8] The Commission's Regulations, 18 C.F.R. § 154.103, require that the "make-up" term be at least five years. Many contracts permit make-up for the life of the contract.

[9] In a few instances, primarily involving very costly wells drilled below the depth of 15,000 feet, Congress removed price controls entirely on November 1, 1979. *See* 15 U.S.C. §§ 3317(c)(1)-(4), 3331(b). Price controls were removed on some other categories on January 1, 1985 and July 1, 1987. *See* 15 U.S.C. § 3331.

[10] *See*, Order of Director, Office of Pipeline and Producer Regulation, Federal Energy Regulatory Commission, issued November 1, 1987, pursuant to 18 C.F.R. § 375.307(k) (1987).

[11] *See* Columbia LNG Corp. v. FPC, 491 F.2d 651, 653-54 (5th Cir. 1974).

By 1983 the shortage of natural gas had been replaced by a surplus of gas deliverability.[12] Competitive pressures from such surplus together with pressures from alternative fuels began to drive down the price of new supplies. In some cases where the pipelines had contracted to pay specified prices without reserving the right to renegotiate if the market price went down, contract prices exceed the new market prices and the cost of alternative fuels. In recent years, the minimum purchase commitments of some pipelines have exceeded their markets and as a result some pipelines are obligated to pay for gas they have not taken.

Pipelines reacted to the abrupt shift from a shortage of gas to a surplus, and to the reduction in market demand, in various ways. Virtually all interstate pipelines ceased executing new long-term contracts with significant take-or-pay commitments. Some pipelines were able to adjust their purchasing practices to balance their gas inventory with reduced demand so that no take-or-pay obligations were incurred. Other pipelines restructured their contracts through negotiations with producers to reduce take obligations and prices, in return for cash payments.[13]

Some pipelines, on the other hand, followed the policy of refusing to take the minimum quantity of high-priced gas required by their contracts, thereby incurring substantial take-or-pay obligations, and sought relief from

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[12] The total proved reserves, however, continued to decline. *See* Energy Information Administration (Office of Oil and Gas) "Advance Summary of the U.S. Crude Oil, Natural Gas, and Natural Gas Liquids Reserves: 1986 Annual Report" (September 1987). This Report indicated that U.S. proved reserves as of December 31, 1986, had declined for five consecutive years, and had reached the lowest level since 1976.

[13] *E.g.*, Columbia Gas Transmission Corporation.

their contracts through Commission orders. This approach was rejected by the Commission.[14]

Although pipelines' reported take-or-pay exposures are very large, a comparison of actual payments with pipeline estimates of "exposure" shows that most of the "exposure" is never realized.[15]

The Commission has dealt with the take-or-pay problem through policy initiatives designed to encourage voluntary renegotiation of pipeline/producer contracts. By a Statement of Policy issued April 10, 1985, the Commission assured pipelines that cash payments to producers to resolve such obligations (which averaged between 10 to 20 cents on the dollar) would not violate NGPA ceiling prices, and could be flowed through to customers in pipeline rate cases, where prudently incurred.[16] While this case was pending in the court of appeals, the Commission issued a Proposed Statement of Policy on take-or-pay, dealing with the method by which such payments could be flowed through without lengthy proceedings.[17] Throughout the entire period from 1982 to the

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[14] App. 134a-135a. Tennessee Gas Pipeline Co. v. Pan-Canadian Petroleum Co., Docket No. RP83-109-000, 37 FERC (CCH) ¶ 61,236 (Dec. 10, 1986), *reh'g denied*, 38 FERC (CCH) ¶ 61,236 (Mar. 10, 1987), *remanded*, No. 87-1206 (D.C. Cir., September 15, 1987) (unreported order). Of the total outstanding take-or-pay obligations of interstate pipelines at the end of 1985 of $6.1 billion, Tennessee owed $2 billion. Tennessee owed $1.7 billion of the $6.8 billion outstanding take-or-pay obligations of all interstate pipelines at the end of 1986. Interstate Natural Gas Association of America [pipeline trade organization] Study "The Unresolved Take-Or-Pay Problem; Year-end 1986 Exposure and Costs" (July 1987) (hereinafter cited as "INGAA Study"), at note 15.

[15] Actual take-or-pay prepayments for the years 1982 through July 31, 1985, appear at App. 141a-144a.

[16] FERC Stats. & Regs. (Regs. Preambles 1982-85) (CCH) ¶ 30,637; discussed, App. 137a-138a.

[17] "Proposed Statement of Policy," Docket No. PL87-3-000, 38 FERC (CCH) ¶ 61,230 (March 5, 1987).

present the Commission has addressed in pipeline rate cases the following issues which bear on the take-or-pay problem: (i) pipeline purchasing practices, (ii) the method of flowing through (or requiring the pipeline to bear) take-or-pay prepayments or settlement costs, and (iii) the costs of settling outstanding unpaid take-or-pay obligations and restructuring high-take contracts.

In the Orders below, the Commission concluded that direct action by it to abrogate or modify contracts for the sale of gas subject to its NGA jurisdiction under its powers in Section 5 of the NGA, or indirect interference with jurisdictional and non-jurisdictional contracts through the imposition of a crediting condition on a producer's right to open-access transportation over interstate pipelines, was bad policy because it raised serious questions about "the ability of parties to rely on private contracts," [18] which were to be the basis of market-determined prices in the future. The Commission found that such actions would relieve the pipelines from the competitive pressures of the marketplace by permitting them to deny transportation to producers who were unwilling to renegotiate their contracts, even if those contracts were not involved in the transportation being sought. The Commission further found that such actions would result in inequities among groups of producers, and among consumers which sought to purchase from them, and would cause undue discrimination under Sections 4 and 5 of the NGA.[19] Finally, the Commission expressed great doubt that it had authority to deny access to producers unless they give up rights contained in contracts no longer subject to the Commission's NGA jurisdiction.[20]

The court of appeals found the Commission's explanations inadequate and unpersuasive. It engaged in its own

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[18] App. 134a-138a.

[19] App. 146a-154a.

[20] App. 135a-137a.

detailed economic analysis of the situation and strongly suggested specific policy alternatives required to be "considered" on remand by the Commission. The court of appeals remanded the case to the Commission "to determine, in light of our discussion of its questionable factual and legal premises, to what extent these policy considerations may justify its inaction on uneconomical producer-pipeline contracts. We do not require that the Commission reach any particular conclusion; we merely mandate that it reach its conclusion by reasoned decisionmaking." [21] The court of appeals' mandate has been widely interpreted as a requirement for Commission action.

REASONS FOR GRANTING THE PETITION

A. The Court Of Appeals Erred In Disregarding NGPA Limits On The Commission's Power To Interfere With Producer Contracts.

In rejecting the Commission's analysis of take-or-pay issues, the court of appeals stated that the Commission should consider conditioning producer access to pipeline transportation on producer willingness to modify the so-called "problem contracts." [22] In response, the Commission immediately imposed such a condition on transportation access.[23] The court's suggestion was premised on

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[21] App. 94a. Judge Mikva would not accept Commission "inaction" on this issue, even if supported by additional explanation and reasoning. *See* dissent, App. 126a.

[22] App. 75a. The court of appeals noted that although parties refer to the problem as take-or-pay, what really is at issue is the price.

[23] Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol, Order No. 500, "Interim Rule and Statement of Policy," 52 Fed. Reg. 30,334, III FERC Stats. & Regs. (CCH) ¶ 30,671 (Aug. 7, 1987); *extension granted*, Order No. 500-A, 41 FERC (CCH) ¶ 61,013 (Oct. 14, 1987); *modified*, Order No. 500-B, 41 FERC (CCH) ¶ 61,024 (Oct. 16, 1987); Order Explaining Crediting Provisions, 41 FERC (CCH) ¶ 61,025 (Oct. 16, 1987) ("Order No. 500 series").

a reading of the Commission's authority which is at odds with the requirements of the NGPA. If uncorrected, the court's construction will lead to years of uncertainty about the consequences of transportation, unjustified denial of access to transportation for many producers, and an unjustified restriction on supplies available to consumers.

The NGPA fundamentally changed the regulatory structure of the natural gas industry, freeing producers from the cost-based price regulations which had led to serious gas shortages in the interstate market, and replacing those regulations with a series of statutory price ceilings, and with phased deregulation of the prices of most new gas supplies. The NGPA was "designed to preserve the Commission's authority under the NGA to regulate natural gas sales from pipelines to their customers; however, it is designed to supplant the Commission's authority to establish rates for the wholesale market, the market consisting of so-called 'first sales' of natural gas." [24] With few exceptions, wellhead prices ultimately were to be determined by free market forces and not by regulatory fiat.

Having created this new structure, Congress was justifiably concerned that the residual Commission authority over interstate pipeline sales and transportation could be used to undermine the free market.[25] As a result, Con-

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[24] Public Service Commission v. Mid-Louisiana Gas Co., 463 U.S. 319, 331 (1983).

[25] *See, e.g.*, Office of Consumers' Counsel v. FERC, 783 F.2d 206, 221 (D.C. Cir. 1986), *motion for enforcement granted*, 826 F.2d 1136 (D.C. Cir. 1987):

> Both the statutory mandate to deregulate producer prices and the available legislative history reflect congressional concern with "back door" regulation of producers. The fear was that if it were easy for FERC to deny passthrough of the prices pipelines paid producers, this would provide an avenue for the Commission to regulate indirectly the prices producers charged.

gress included several provisions designed to insure that the Commission could not undermine the policy decisions implicit in the NGPA. First, although Congress authorized the Commission to increase certain ceiling prices,[26] it did not authorize the Commission to reduce the ceiling prices set by the NGPA or to reimpose price ceilings for deregulated gas.[27] Second, to assure that the Commission could not regulate the prices indirectly, Congress specified that all prices at or below the applicable NGPA ceiling and all unregulated prices were to be deemed "just and reasonable," [28] and that the Commission could not deny pipelines the right to recover such costs in the absence of fraud or abuse.[29] Finally, to assure that the Commission could not use its power under Section 7 of the NGA to condition access to jurisdictional transportation facilities as a tool to regulate wellhead prices,[30] Congress provided that the Commission "may not deny or condition

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[26] NGPA § 104(b)(2), 15 U.S.C. § 3314(b)(2) (1982), and NGPA § 106(c), 15 U.S.C. § 3316(c) (1982).

[27] The President was given limited authority to reimpose maximum lawful prices for deregulated gas. *See* NGPA § 122, 15 U.S.C. § 3332 (1982).

[28] NGPA § 601(b), 16 U.S.C. § 3431(b) (1982). This declaration severely restricts the Commission's authority to abrogate producer contracts remaining within its jurisdiction under its NGA Section 5 authority. The Commission's power under NGA Section 5 is predicated upon a determination that rates, charges, or other terms set forth in existing contracts are unjust and unreasonable, but the NGPA effectively bars the Commission from interdicting contracts based upon consideration of prices. Section 101(b)(9), 15 U.S.C. § 3311(b)(9) (1982).

[29] NGPA § 601(c)(2), 15 U.S.C. § 3431(c)(2) (1982).

[30] This Court had held, for example, that the Commission could condition transportation certificates to assure that the sales price did not exceed the Commission's set rates even where the Commission did not have authority to regulate directly the price being charged. FPC v. Transcontinental Gas Pipe Line Corp., 365 U.S. 1 (1961).

the grant of any certificate" based on the amount to be paid in the sale so long as the price is one deemed "just and reasonable" under Section 601(b).[31]

The Commission, in Order No. 436, refused to violate the clear precepts of the NGPA and condition transportation access on modification of "problem contracts."[32] The court of appeals found the Commission's obedience to the limitations imposed by the NGPA to be reversible error. Ignoring the clear statutory prohibition against the Commission's interference in producer/pipeline pricing issues, the court of appeals instructed the Commission to explain more thoroughly its reluctance to interfere in the pricing and terms of contracts negotiated under circumstances that Congress declared to be outside the realm of regulatory oversight.

The court's instruction that the Commission reconsider its decision not to invoke NGA Section 5 to set aside or modify take-or-pay provisions in jurisdictional contracts, was improper.[33] The court conceded that take-or-pay clauses are "a perfectly natural allocation of risk between producer and purchaser"[34] and that even a clause that specifies one hundred percent takes is not *per se* unreasonable. The court recognized that it is only the combination of take-or-pay clauses with high contract prices which causes problems.[35] Although the court char-

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[31] NGPA § 601(c)(1), 15 U.S.C. § 3431(c)(1) (1982).

[32] App. 75a.

[33] The Commission lacks jurisdiction to modify the terms of contracts that are not subject to its jurisdiction under the NGA. Pennzoil Co. v. FERC, 645 F.2d 360, 380-83 (5th Cir. 1981), *cert. denied*, 454 U.S. 1142 (1982); App. 89a n.30. The NGPA does not provide the Commission with any independent authority to modify contract terms. Pennzoil Co. v. FERC, 645 F.2d at 374-75.

[34] App. 75a.

[35] App. 75a.

acterized the prices as "high,"[36] the NGPA requires that such prices be accepted as just and reasonable for the purpose of Section 5.[37] To set aside or modify a take-or-pay clause because the price required to be paid is deemed to be too high would be an *ultra vires* act beyond the Commission's statutory authority.[38]

The second alternative the court directed the Commission to consider on remand is conditioning producers' access to transportation as a means of solving take-or-pay issues. The court recognized that such conditioning power, if exercised, may have the effect of forcing reductions of producer prices. Indeed, that would be the purpose of the condition. The court argued, however, that while the results may be the same, access conditions are not the same as direct wellhead price controls.[39] The court's conclusion might not be at odds with the NGPA if Congress had simply prohibited the Commission from direct price controls. It is, however, irreconcilably at odds with Congress' prohibition of indirect action to interfere with the operation of the free market and of the statutory ceiling prices.

While the court of appeals was critical of the Commission's failure to condition access on modification of problem contracts, it did not discuss the authority under

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[36] App. 90a.

[37] NGPA § 601(b), 15 U.S.C. § 3431(b). The court itself acknowledged that invocation of Section 5 may be problematic insomuch as the "FERC is clearly barred from setting sub-NGPA ceilings on jurisdictional wellhead sales"; and any Section 5 action instituted without regard to price "would not reach many contracts that are deleterious only because very high price provisions combine with otherwise harmless take-or-pay clauses" and may "restrict contracts that are harmless despite high take-or-pay problems." App. 90a; *see also*, App. 79a n.26.

[38] App. 79a.

[39] App. 93a-94a.

which such conditions could be imposed.[40] As noted above, Section 601(c)(2) of the NGPA speaks directly to the Commission's conditioning authority under Section 7 of the NGA and prohibits the Commission from conditioning *any* certificate based on amounts paid, as long as the prices comply with applicable provisions of Title I of the NGPA. This restriction, in plain terms, applies to transportation certificates as well as sales certificates.[41]

While the Commission has authority to specify terms and conditions for transportation provided under Section 311,[42] that authority cannot be read to undermine the clearly expressed congressional intent to prevent any regulatory interference with the free market pricing scheme set out in the NGPA. Section 601(a)(2)(A)(ii)[43] excludes from the Commission's NGA jurisdiction transportation of gas in interstate commerce under Section 311.

Section 311 was designed to encourage integration of interstate and intrastate systems into a national supply grid by assuring the pipelines that they would not be subject to the Commission's NGA regulation. To suggest that Congress permitted the Commission to impose conditions on Section 311 transactions that are expressly prohibited with respect to Section 7 transactions is inconsistent with the structure and purpose of Section 311.

The Commission's statutory mandate is to "overse[e] a national market price regulatory scheme."[44] Contrary

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[40] Such authority cannot merely be inferred from the Commission's general statutory charge.

[41] NGPA § 601(c), 15 U.S.C. § 3431(c).

[42] NGPA § 311(a), 15 U.S.C. § 3371(a) (1982).

[43] 15 U.S.C. § 3431(a)(2)(A)(ii).

[44] Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi, 474 U.S. 409, 106 S.Ct. 709, 716 (1986).

to the decision of the court of appeals, the Commission is statutorily prohibited from barring producers' access to jurisdictional facilities to effect "government pressure to reduce prices." [45] It was for the very purpose of preventing government pressure to reduce prices that Section 601(c)(1) was enacted.

The court of appeals is precluded from inciting regulatory action that:

> . . . undermines Congress' determination that the supply, the demand, and the price of [deregulated] gas be determined by market forces. To the extent that Congress denied FERC the power to regulate affirmatively particular aspects of the first sale of gas, it did so because it wanted to leave determination of supply and first-sale prices to the market.[46]

The Commission in Order No. 436 carefully balanced the authorities given to it to control pipeline behavior within the strict limitations placed upon its power to interfere directly or indirectly with prices and terms of wellhead purchases. The Commission utilized its authorities in the manner contemplated by Congress, using its NGA authorities to reduce the monopoly power inherent in interstate pipeline companies that prevented customers from enjoying the fruits of competition in producing area markets. However, the Commission refused to interfere with the pipeline/producer agreements which Congress had determined should be left to the free market. The action of the court of appeals in setting aside the Commission's Order No. 436 because the Commission observed the limits of its mandates, creates and relies upon an erroneous construction of the NGPA.

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[45] App. 94a.

[46] Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi, 474 U.S. at ——, 106 S.Ct. at 716-17.

B. The Court Of Appeals Erred In Failing To Defer To The Commission's Decision On Factual And Policy Matters.

As the court of appeals recognized throughout its opinion,[47] it is the Commission, not the courts of appeals, that is charged by Congress with the primary authority and responsibility to administer the statute.[48] "The court's responsibility is not to supplant the Commission's balance of these interests with one more nearly to its liking, but instead to assure itself that the Commission has given reasoned consideration to each of the pertinent factors." [49]

The courts of appeals must defer to agency findings of facts based upon substantial evidence.[50] Often the agency cannot measure the proposed regulation's effect until after it has been implemented.[51] Consequently, rulemaking must sometimes rest on judgment and prediction that cannot be completely supported by existing data.[52] In such cases, complete evidentiary support for the Commission's ultimate conclusion is not required.[53] When examining an agency's prediction within its area of special expertise, a reviewing court must afford the greatest deference.[54]

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[47] App. 34a, 45a.

[48] Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 844 (1984).

[49] Mobil Oil Corp. v. FPC, 417 U.S. 283, 308 (1974).

[50] NGPA § 506(a)(4), 15 U.S.C. § 3416(a)(4) (1982); NGA § 19(b), 15 U.S.C. § 717(b) (1982).

[51] Telocator Network of America v. FCC, 691 F.2d 525, 542 (D.C. Cir. 1982).

[52] *See, e.g.*, FCC v. WNCN Listeners Guild, 450 U.S. 582, 594-96 (1981); FCC v. National Citizens Committee for Broadcasting, 436 U.S. 775, 813-14 (1978).

[53] *Id.*

[54] Baltimore Gas & Electric Co. v. Natural Resources Defense Council, Inc., 462 U.S. 87, 103 (1983).

In this case, the court of appeals has imposed its view of the future and rejected the Commission's own analysis. The Commission's decision, however, reflected reasoned consideration of relevant issues.

In subtle deference to this Court's instruction, the court of appeals cast its order in the form of a requirement that the Commission provide further "explanations" or "reasoning" in support of its decision. Without such explanation, the court of appeals clearly expected the Commission to: (i) modify the quantity provisions of jurisdictional contracts under Section 5 of the NGA; or (ii) impose a condition which would require producers to cede rights under their long-term gas sales contracts in order to obtain transportation of the gas.[55] Should the Commission elect to stand firm on its position on these issues after reconsideration, it would face further review by the court of appeals on whether its further "explanation" was sufficient. The court of appeals thereby sought to coerce the Commission to adopt *its* view of these issues, instead of the Commission's *own analysis.* In the meantime, the manner in which the entire interstate pipeline industry will operate, and the manner in which the producers and consumers of natural gas will buy and sell an essential national commodity, remain in doubt.

The Commission decision not to condition producer access to transportation on granting of take-or-pay relief or taking action under Section 5 of the NGA is consistent with the purpose of the NGPA.[56] Congressional pol-

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[55] App. 89a-94a.

[56] This Court accords great deference to the interpretation given the statute by those agency officials charged with its enforcement. Udall v. Tallman, 380 U.S. 1, 16-17 (1965); Red Lion Broadcasting Company, Inc. v. FCC, 395 U.S. 367, 381 (1969); Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519 (1978). Motor Vehicle Manufacturers Ass'n v. State Farm Mutual Insurance Co., 463 U.S. 29, 42-6 (1983). Whenever decision as to the meaning or reach of a statute has involved reconciling conflicting policies, the Court

icy, as embodied in the NGPA, is to move towards a deregulated gas commodity market. Interfering with producer/pipeline contracts would introduce artificial distortions into the gas sales market and would not be consonant with congressional intent.[57]

The Commission's decision in Order No. 436 is consistent with the prohibitions of the NGA against undue discrimination. Conditioning producer access would run completely counter to the whole idea of opening up the transportation grid on a non-discriminatory basis.[58] It would be inconsistent with the non-discrimination requirement of both Order No. 436 and the NGA.[59] It would discriminate against producer/sellers and certain buyers and hinder the flow of gas from willing sellers to willing buyers.[60] The effect of the condition on access is to allow the pipeline to use its monopoly power over transportation to force the producer to modify his contracts with that pipeline.

The Commission considered the alternatives "suggested" by the court of appeals and clearly articulated its reasons for not abrogating private contracts or otherwise conditioning access to jurisdictional facilities. First, the Commission noted that the bulk of the perceived problem existed in contracts not subject to its jurisdiction.[61]

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will defer to the agency's expertise if its choice is reasonable, unless it appears from the statute or legislative history that the accommodation is not one that Congress would have sanctioned. Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 844-46 (1984); United States v. Shimer, 367 U.S. 374, 382-83 (1961).

[57] App. 133a-135a.

[58] App. 137a.

[59] App. 147a-148a.

[60] App. 152a.

[61] The court of appeals noted that higher-priced Outer Continental Shelf gas remains subject to the Commission's jurisdiction

The proportion of wellhead sales still subject to the NGA is steadily declining. It would be incomplete and inequitable to allow pipelines to reduce their takes only under contracts still subject to the Commission's NGA jurisdiction.[62]

Second, the Commission noted the strong public policy objections to abrogating the private contracts of natural gas producers and interstate pipelines. Private contracts are the foundation of the gas industry.[63] The Commission reasonably concluded that it should not interfere with the ability of private parties in this industry to rely on private contracts as a tool for structuring basic economic relationships.[64]

Third, the Commission reasonably concluded that the pipelines could and would renegotiate their "problem" contracts with producers without governmental interference. The Commission found that an adequate regulatory climate existed under which pipelines may work with producers to deal with their take-or-pay contracts.[65] The Commission also concluded that the April 10, 1987 policy statement and procedure for granting expedited producer abandonments will assist settlement of outstanding take-or-pay and deter accrual of take-or-pay.[66]

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under Section 102 of the NGPA, 15 U.S.C. 3312 (1982). However, only new natural gas from "old" Outer Continental Shelf leases remains under Commission jurisdiction under Section 102(d). Natural gas produced from new Outer Continental Shelf leases under Section 102(c) has been removed from Commission jurisdiction pursuant to Section 601(a)(1)(B)(ii), 15 U.S.C. § 3431(a)(1)(B)(ii).

[62] App. 153a-154a.

[63] Even the court of appeals recognized "[u]nilateral abrogation of a contract is an extreme measure." App. 66a. *See, also,* United Gas Pipe Line Co. v. Mobile Gas Service Corp., 350 U.S. 332 (1956).

[64] App. 134a.

[65] App. 151a-152a.

[66] App. 150a-151a.

The Commission determined that pipelines continued to make progress in renegotiating their contracts with producers.[67] Prepayments were declining and accrued take-or-pay liability is being reduced.[68] Pipelines had ample bargaining power with producers to renegotiate their take-or-pay contracts.

Initial implementation of Order No. 436 has yielded empirical data demonstrating the soundness of the Commission's predictions. Pipelines and producers have settled all but ten to fifteen percent of take-or-pay accruals. Negotiated contract restructuring that provides for market responsive pricing and reduced take requirements will reduce future accruals. The pipeline trade association forecasts the take-or-pay liability accruing in 1987 to be down 20 percent from take-or-pay liability accrued in 1986.[69] Producers have filed for permanent abandonment of substantial volumes of jurisdictional gas that would reduce deliverability committed to the pipelines and hence take-or-pay requirements.

Market pressures are forcing restructuring of these contracts at a rapid rate, with producers waiving their contract rights for compensation amounting to 10 to 20 cents on the dollar.[70] In 1985 and 1986 pipelines paid a total of $700 million for contract reformation, to reduce or eliminate future take-or-pay obligations under the contracts affected.[71]

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[67] App. 136a-137a, 149a.

[68] App. 136a-137a, 149a.

[69] *See*, INGAA Study, *supra* note 14.

[70] App. 141a-144a; U.S. Department of Energy "Increasing Competition in the Natural Gas Market; Second Report Required by Section 123 of the Natural Gas Policy Act" (January 1985), 5-4 to 5-8; INGAA Study, *supra* note 14, at 5-7.

[71] INGAA Study, *supra*, Table 4, p. 9.

Massive quantities of gas have been released from producer/pipeline contracts, which are then cancelled, or the released gas is credited against the contract obligations when resold by the producer to new buyers at reduced prices. Even the court of appeals noted: "FERC policy arguments in favor of subjecting pipelines to the pressures of a competitive market seem powerful and well grounded in the statutes it is authorized to enforce." [72]

The Commission predicted that the market would solve the "problem" and indeed, market pressures are forcing restructuring of these contracts at a rapid rate. In essence the court of appeals rejected the Commission's conclusions, calling the Commission's economic projections "utterly Panglossian." [73] The underlying basis of the court's opinion is the conclusion that "market forces" will fail, or will be prevented from operating, and therefore some form of judicial/administrative solution is required. By substituting its judgment for that of the Commission, the court of appeals erred.

C. The Commission Has Discretion To Select The Proceeding In Which It Addresses Discretionary Issues.

Whether the Commission is required to deal with the take-or-pay problem *in this proceeding*, or whether it may deal with the problem in individual pipeline rate cases and rulemaking proceedings to allocate the cost of reforming uneconomic pipeline/producer contracts between pipelines and their customers, is an issue which the court of appeals decided against the Commission, without discussion or supportive reasoning.

This Court has spoken directly on the Commission's power to resolve pipeline take-or-pay problems in pipeline rate cases, rather than in direct action against the pro-

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[72] App. 88a.

[73] App. 94a.

ducers. In *FPC v. Sunray DX Oil Co.*,[74] the Commission had refused to take into account pipelines' take-or-pay problems in producer proceedings. The District of Columbia Circuit, the same Court that remanded Order No. 436, found that the Commission erred in declining to come to grips with the issue in producer certificate proceedings. This Court disagreed, finding that pipeline take-or-pay problems could properly be considered in pipeline rate proceedings.[75] This is precisely what the Commission seeks to do here, and which the court of appeals found to be inadequate.

Ample authority supports the power and discretion of an administrative agency to select the forum in which issues are addressed.[76]

The court of appeals' opinion seeks to lead the Commission into the position of reinstating the pipelines' monopoly power to deny a producer or his customer transportation of gas unless and until the producer is ready to waive provisions in long-term gas sales contracts in which the pipeline assumed the risk of market demand.[77]

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[74] 391 U.S. 9 (1968).

[75] 391 U.S. at 49-52. In the rulemaking (Order No. 334, 37 F.P.C. 110 (1967)) referred to by the Court in *Sunray*, 391 U.S. at 50 n.51, the Commission declined to abrogate take-or-pay provisions under its Section 5 authority. The Commission's judgment was vindicated by subsequent events. The growing gas shortage in the 1970's allowed take-or-pay balances to be "made-up" by pipelines without losses. Many authorities believe similar results will occur in the gas market in the next few years.

[76] *See* SEC v. Chenery Corp., 332 U.S. 194, 201-04 (1947); NLRB v. Bell Aerospace Co., 416 U.S. 267, 294 (1974); NAACP v. FPC, 425 U.S. 662, 668-69 (1976); Vermont Yankee Nuclear Power Corp. v. NRDC, 435 U.S. 519, 531-35, 543, 546 (1978); FPC v. Transcontinental Gas Pipe Line Corp., 423 U.S. 326 (1976); FCC v. Schreiber, 381 U.S. 279, 290 (1965); Fort Pierce Utility Authority v. FPC, 526 F.2d 993, 995, 998-99 (5th Cir. 1976).

[77] Universal Resources Corp. v. Panhandle Eastern Pipe Line Co., 813 F.2d 77, 80 (5th Cir. 1987).

In so doing, the Court of Appeals substituted its judgment for that of the Commission, in violation of the standards of review laid down by this Court.[78]

CONCLUSION

The Writ should be granted.

Respectfully submitted,

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[78] Permian Basin Area Rate Cases, 390 U.S. 747, 767 (1968); Mobil Oil Corp. v. FPC, 417 U.S. 283 (1974); Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984).

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